No. 22

In the Supreme Court of the United States

OCTOBER TERM, 1962

UNITED STATES, PETITIONER

v.

TALBOT PATRICK, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES ON REARGUMENT[1]

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[1] This brief replaces the original brief on the merits filed by the United States.

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OPINION BELOW

The opinion of the district court (R. 46-52) is reported at 186 F. Supp. 48. The opinion of the court of appeals (R. 59-67) is reported at 288 F. 2d 292.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 1961. (R. 68.) On June 24, 1961, by order of the Chief Justice, the time for filing a petition for writ of certiorari was extended to and including July 25, 1961. The petition was filed on July

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[1] This brief, and the separate brief being filed in *United States* v. *Gilmore*, No. 21, replace the joint brief filed in the two cases in the 1961 Term (Nos. 255 and 256).

25, 1961, and granted on October 9, 1961. (R. 69, 368 U.S. 817). The case (No. 256, 1961 Term) was argued on March 28, 1962, and by order of April 2, 1962, was restored to the calendar for reargument (369 U.S. 835). The jurisdiction of this Court rests on 28 U.S.C. 1254 (1).

QUESTIONS PRESENTED

1. Whether the following attorneys' fees incurred by a husband in effecting a property settlement agreement incident to a divorce qualify as "ordinary and necessary expenses paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income" so as to be deductible under § 212(2) of the Internal Revenue Code of 1954, or are nondeductible "capital" or "personal" expenses:

(a) The fees for services in negotiating a purchase by the husband of his wife's stock in a corporation of which he was president, the object of the purchase being to give the husband a controlling interest in the corporation;

(b) The fees for services in negotiating a new long-term lease to the corporation of real property owned by the spouses;

(c) The fees for services in negotiating and executing a transfer of the leased property to a trust, to pay the income to the wife for life and then to convey the property in equal shares to the parties' three children;

(d) Such part of the fees thus paid as may be deemed to have served also the object of forestalling

an assertion by the wife of her rights to a substantial part of the taxpayer's property in satisfaction of his marital obligations to her.

2. Whether the taxpayer may deduct any part of the fees paid by him to his wife's attorneys for services performed in her behalf.

STATUTES AND REGULATIONS

The pertinent statutes and regulations are set forth in the Appendix to our brief in the companion case, *United States v. Gilmore*, No. 21.

STATEMENT

1. In 1955, the respondent's wife[1] filed suit for an absolute divorce on grounds of her husband's adultery. There were three children of the marriage, one of whom had attained majority (R. 4).

At the time of the divorce suit, the respondent was president of the Herald Publishing Company in Rock Hill, South Carolina, and editor of the newspaper published by it. (R. 3.) He owned 28% of the Company's stock, his wife owned 28%, and their adult son, Hugh, owned 9%. The remaining 35% was held in trusts for the three children which had been established by Mrs. Patrick's father. The real property which housed the newspaper was owned in common by Mr. and Mrs. Patrick, their interests being ⅘ and ⅕, respectively. (R. 4.) The couple

[1] Talbot Patrick will be referred to as the sole respondent. The administrator of the estate of his second wife, Alethia M. Patrick, is a party only because a joint return was filed in 1956. Paula M. Patrick, the former wife, will be referred to as taxpayer's "wife", notwithstanding the divorce.

also owned two houses. (R. 8.) In addition, each of the spouses independently owned diversified securities and other assets of substantial value.[3] (R. 16–17, 25–26, 37.)

Pending the divorce suit and prior to the filing of the respondent's answer (R. 30), the parties negotiated an agreement settling "all rights whatsoever * * * concerning the matter of support, separate maintenance, alimony or any financial obligation of whatsoever sort due to [the wife] * * * on account of and growing out of the marital relationship" (R. 13). Besides provisions for the custody and support of the minor children and a provision giving one of the two houses to each of the parties, the agreement was concerned solely with ~~the~~ disposition and readjustment of the parties' intertwined interests in the newspaper properties; none of the other income-producing properties of either spouse was dealt with (R. 7–15).

The nature of the negotiations leading to the agreement is fully disclosed by the depositions of the attorneys representing the two parties (Spencer, R. 29–41, 55–56; Lumpkin, R. 41–46, 56–57), and there is no conflict between them as to the character of the negotiations and the purposes of the attorneys in conducting them (see, *e.g.*, R. 44). On behalf of Mrs. Patrick, her attorney considered it desirable that Mr.

[3] The court of appeals' statement that the newspaper properties were the "only" income-producing properties of the parties (R. 60) is in error. Not only did the respondent have $112,000 worth of blue-chip securities to exchange with his wife (see below, p. 5), but of his some $55,000 of gross income reported for 1956, no more than about $25,000 was traceable to the newspaper properties (see R. 25–26, 37, 38).

Patrick continue as editor of the newspaper. (R. 44-46.) His attorney, however, thought that notwithstanding the absence of any present disagreement, Mr. Patrick should assure himself against being outvoted in the future by the combined voting power of Mrs. Patrick, and her son, Hugh, who seemed somewhat to side with her (R. 18, 55-56), and advised him to seek to acquire control of the publishing company by buying Mrs. Patrick's shares (R. 31-32, 34-36, 40). Mrs. Patrick recognized that she could not expect him to continue to manage the newspaper, in the light of their strained relations, subject to the threat of being outvoted, and she was quite willing to sell her shares to him for their fair value. (R. 38, 40, 43-46.) Her only concern, her attorney explained, was to make sure that the newspaper properties would ultimately go to the children (R. 43, 44-45), one of whom was already in the business and the other of whom was preparing to enter it (R. 37). Mr. Patrick's own attorney similarly understood that Mrs. Patrick, having adequate independent means, did not want anything for herself and was concerned only to protect the interests of the children (R. 37). Mr. Patrick, in turn, was entirely agreeable to assuring the ultimate devolution to the children, who were equally the objects of his bounty. (R. 25, 38-39.)

The outcome of the negotiations was an agreement that Mr. Patrick would give to Mrs. Patrick high-quality listed securities acceptable to her equal in value to the agreed value of her 28% of the publishing company stock ($112,000, R. 38), and that Mrs. Patrick would transfer her stock to him subject to the

condition that it should go in equal shares to the children in the event of his death or in the event of a sale of the entire business.[4] (R. 11-12.) As to the real property housing the newspaper, a new long-term lease with the newspaper was negotiated and both parties then transferred their interests to a trust, with the income to be paid to the wife for life[5] and the property then to go in equal shares to the three children. (R. 8-10.) Finally, Mr. Patrick agreed to pay all of his wife's attorneys' fees in connection with the divorce and the negotiation of the property agreement. (R. 12.)

After the agreement was concluded, the respondent filed an answer in the divorce suit neither admitting nor denying the alleged adultery (R. 30). Following a brief and uncontested trial establishing the grounds for divorce, a decree was entered granting Mrs. Patrick a divorce and incorporating and approving the settlement agreement that had been reached by the parties (R. 46-47).

2. During 1956, the respondent paid attorneys' fees for all services connected with the divorce and the agreement, totaling \$24,000—\$12,000 to his attorneys and \$12,000 to his wife's attorneys. The total of \$24,000 was allocated by agreement of counsel and

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[4] The condition attached only to the shares purchased from Mrs. Gilmore. It did not attach to the 28% already owned by Mr. Gilmore (see R. 11-12) and the court of appeals' statement to the contrary (R. 60-61) is in error.

[5] The court of appeals' opinion is in error in describing the trust as being solely for the children (R. 61), since it omits the wife's life estate.

the parties, without distinction between the wife's fees and the husband's, as follows: $4,000 for obtaining the divorce itself; $16,000 for negotiating the stock transfer; and $4,000 for negotiating the new lease of the real property and transferring the property to the trust. (R. 6, 32-33, 36, 47, 56.) Mr. Patrick claimed a deduction for the $16,000 item and for 4/5 ($3,200) of the $4,000 item relating to the business real estate. (R. 6-7.) Both courts below held that the entire $19,200, without distinction between the fees paid to the husband's attorneys and those paid to the wife's attorneys, was deductible under Section 212(2) of the Internal Revenue Code of 1954[3] as an "ordinary and necessary expense paid or incurred * * * for the management, conservation, or maintenance of property held for the production of income." (R. 49-51, 67.)

ARGUMENT

Despite our filing of a joint brief in the two cases at the last Term, this case, upon analysis, is quite different in its main aspects from its companion, *United States v. Gilmore*, No. 21. The difference is that most of the items in dispute in this case do not, in our view, involve an assertion either of marital

[3] All references in this brief are to the 1954 Code. The following table correlates the relevant 1939 Code sections, discussed in our *Gilmore* brief, with those of the 1954 Code:

1939 Code	*1954 Code*
§ 23(a)(1)	§ 162
§ 23(a)(2)	§ 212(1) and (2)
§ 24(a)(1)	§ 262
§ 113(b)(1)(A)	§ 1016(a)(1)

rights or of adverse property claims. At least if the content of the negotiations and the resulting agreement be the guide, what this case primarily involves is simply a purchase and sale of stock between two parties who happen to be husband and wife and a long-term lease of real estate to a corporation by the persons who own it, who again happen to be husband and wife." Consequently, as we will show in Point I, the reason why most of the expenses of negotiating and executing the agreement were not deductible is not that they were "personal" expenses (though some of them were), but that they were "capital" expenditures. In Point II we will show that, if the wife's marital rights, though not overtly asserted, be nevertheless taken into account as a "latent" threat indirectly forestalled by the attorneys' services, it would go only to establish that a greater part of the costs should be treated as "personal" expenses for which not even an addition to basis should be allowed. In Point III, we note that the respondent is in no event entitled to a deduction for the fees paid his wife's attorneys.

I

THE COSTS OF NEGOTIATING MOST OF THE ELEMENTS OF THE AGREEMENT WERE CAPITAL IN NATURE, THOSE OF THE REMAINING ELEMENTS WERE PERSONAL

As we understand the allocation of the fees made, no deduction was claimed for the services of the attorneys in negotiating the amount the respondent was to pay for the support of the two minor children, the disposition of the two homes, and like matters. The deductions claimed and allowed were limited

rather to the fees for the attorneys' services (1) in negotiating the respondent's acquisition of his wife's 28% share of the stock of the publishing company; (2) in negotiating a new long-term lease of the real property to the corporation; and (3) in creating the trust and transferring the real property (subject to the lease) to it. Limiting our discussion to those items, we will show that the first two items were primarily "capital" expenditures and that the last item was a "personal" expense.

1. *Negotiation of the stock purchase.*—In order to acquire a controlling stock interest in the corporation and thereby assure himself against being outvoted should dissension with his ex-wife ever arise, the respondent gave his wife diversified securities of an equal value ($112,000) in exchange for her 28% of the stock. The costs of negotiating that stock acquisition, like the expenses of effecting the purchase of any capital asset, were nondeductible capital expenditures. It is no doubt true that the respondent, until he acquired a controlling stock interest, would stand in jeopardy of being ousted from his position as president of the corporation should he lose favor with those who controlled a majority of the stock. That, however, is true of every corporate officer who owns less than a controlling interest in the corporation by which he is employed; the officer whose tenure does not depend upon the favor of others is, we should suppose, the exception rather than the rule. Until this case, however, it has never been suggested that that circum-

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Regs. (1954 Code), § 1.263(a)-2; *Helvering* v. *Winmill*, 305 U.S. 79; *[illegible]* v. *Commissioner*, [illegible] F. 2d [illegible] (C.A. [illegible]).

stance converts the expense of buying up a company to assure one's tenure in its employ into an ordinary and necessary expense of carrying on the "trade or business" of being an employee of the corporation.[8] Voting power is a basic attribute of corporate stock, and the power its ownership gives to control (among other things) the corporation's personnel decisions is but one of the things that gives stock its value as a capital asset.[9]

The respondent did not acquire unfettered ownership of his wife's stock but took it subject to the condition that it pass to the three children upon his death or a sale of the corporation. If that affects the conclusion, it does so by suggesting that part of the expenses of the stock transfer should be treated as "personal" expenses not allowable even as a basis addition. The transfer of the "remainder" to the children can be seen as a gift from the respondent to his children or as a transaction approaching, as the coercion from his wife to make the "gift" increases, a transfer of values from the respondent to his wife in recognition of her marital rights (by his paying full value for the stock but receiving less than a life estate) and a gift by her to the children. In either

[8] The respondent's job was a "trade or business" and thus the relevant provision of the Code on the court of appeals' theory of the case (a cost of keeping the job) is § 162, not, as the court assumed, § 212(2).

[9] Whether the power marriage gives to "control" one's wife's votes is of equal reliability we need not debate. However efficacious it might be, marital "control" is not a capital asset, and its replacement with stock ownership is something more than a mere preservation of an existing status, the court of appeals to the contrary notwithstanding (R. 61, 65).

view, that aspect of the transaction is purely "personal" and any part of the fees allocable to it would be both nondeductible and noncapitalizable.

2. *Negotiation of the long-term lease.*—In negotiating a long-term lease of the building to the corporation, the respondent wore two hats, acting both for the corporation as lessee and for himself as lessor. To the extent that the fees were incurred to assure the corporation's future right to occupy the premises (*i.e.*, on behalf of the lessee), they should have been paid by the corporation,[10] and the respondent's payment of them constituted a contribution of capital to the corporation. To the extent that the fees were for services on behalf of the lessors, they were required to be capitalized as the cost of obtaining a long-term lease, recoverable through amortization deductions over the term of the lease.[11] Either way, the fees were, as to the respondent, nondeductible capital expenditures.

3. *Creation of the trust.*—Under the agreement, the respondent and his wife joined in conveying the building (subject to the new lease) to a trust, the income to be paid to the wife for life ~~and the~~ property then

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[10] *Deputy* v. *duPont*, 308 U.S. 488. Even if the corporation had paid the fees itself, it would have been required to capitalize them as the cost of obtaining the leasehold and amortize them over its term. Regs. (1954 Code), § 1.162-11(a); see § 178(a)(2) of the Code.

[11] *E.g.*, *Helvering* v. *Manhattan Life Ins. Co.*, 71 F. 2d 292 (C.A. 2); *Young* v. *Commissioner*, 59 F. 2d 691 (C.A. 9); *Commissioner* v. *Chicago Dock & Canal Co.*, 84 F. 2d 288 (C.A. 7); cf. Regs. (1954 Code), § 1.167(a)-3. If the transfer of the leased property to the trust be treated as a gift, with the trust taking the grantor's basis, the trust would acquire the right to the amortization deductions. See §§ 1015, 167(f).

to go in equal shares to the three children. However viewed, the costs both of negotiating and of effectuating that agreement were, in their entirety, nondeductible "personal" expenses. To the extent that the wife gained something for herself by the transaction—*i.e.*, if her acquired life interest in the whole was of greater value than her relinquished fee interest in one-fifth—there was a transfer to her in recognition of her marital rights. The transfer of the remainder to the children was of the same character as in the stock transfer considered above and, as there shown, was either a gift from the respondent to the children or a transfer in recognition of his wife's marital rights, in either of which events it remains a purely personal transaction.

II

TO THE EXTENT THAT THE COSTS OF ARRIVING AT THE SETTLEMENT ARE TREATED AS A COST OF FORESTALLING AN ASSERTION OF LATENT MARITAL RIGHTS, THEY WERE PERSONAL AND MAY NOT BE TAKEN INTO ACCOUNT EVEN AS AN ADDITION TO BASIS

In Point I, we based the characterization of the attorneys' fees on the nature of the matters to which their services were immediately directed and showed that on that approach the costs were primarily "capital" expenditures (which, though not currently deductible, could nevertheless be accounted for by a basis adjustment). The courts below, however, emphasize the existence of substantial, if latent, marital rights and the indirect consequence of the attorneys' services in forestalling, by arriving at a satisfactory agreement on the other matters, an overt assertion of those

rights. The reasoning is this: the respondent's wife was entitled to an absolute divorce because of his undenied adultery;[12] a divorce on that ground would entitle her to "a substantial property settlement"; "all" of the respondent's property was thus "at risk until settlement was made" (R. 49); the negotiation of an agreement satisfactory to the wife, therefore, even though nominally one for the purchase by the respondent of *her* property, served ultimately to protect *his* property from an assertion of the wife's latent rights; and hence the attorneys' fees were a cost of protecting the respondent's income-producing property from his wife's potential claims for a marital settlement.

We are entirely willing to accept that view of the matter, for as shown at length in our *Gilmore* brief, the costs of resisting (or, here, forestalling) an assertion of inchoate rights arising from the marriage relationship are plainly "personal" expenses, a deduction for which is expressly disallowed by § 262 of the Code. The effect of so viewing the case would not be to improve the current deductibility of the costs, but rather to preclude the right to account for them even by an addition to basis. We have characterized the fees as being primarily a cost of purchasing the wife's stock and of leasing the building, rather than a cost of resisting an assertion of marital rights, *only* because that seems to us the proper analysis, not because we have anything to gain by opposing the latter characterization.

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[12] For the record, we might note that respondent's answer, failing to deny the charge, was not filed until *after* the property agreement was reached (R. 30).

III

RESPONDENT IS NOT IN ANY EVENT ENTITLED TO A DEDUCTION FOR THE FEES PAID HIS WIFE'S ATTORNEYS

The respondent is not in any event entitled to deduct the fees paid to his wife's attorneys for services performed in her behalf.[7] See *United States* v. *Davis*, 370 U.S. 65, 74-75, argued as a companion to this case in the arguments last term; *Lewis* v. *Commissioner*, 253 F. 2d 821, 828 (C.A. 2). The services were in behalf of the wife, not of the respondent, and a taxpayer cannot deduct as his own the expenses of another (*Welch* v. *Helvering*, 290 U.S. 111; *Deputy* v. *duPont*, 308 U.S. 488) even though he be obligated to pay them (*Magruder* v. *Supplee*, 316 U.S. 394; *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590).

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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[7] In *Owens* v. *Commissioner*, 273 F. 2d 251 (C.A. 5), relied on by the court below, the attorney was found to be working for the husband.

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